Andreas Dombret: The role of central banks

Opening statement by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, to the panel discussion at the AICGS (American Institute for Contemporary German Studies) Panel, Berlin, 12 June 2013.

*   *   *

Ladies and gentlemen

The events of the past five years have called into question many assumptions that were the foundations of our monetary and financial system.

But while it is necessary to draw the right conclusions from the current crisis, we should not discard the lessons we have learned from previous crises – for they remain equally valid. The cautious role of central banks in spurring economic growth is such a lesson – a lesson we learned the hard way in the 70s and 80s. Some central banks tried to foster economic growth by reducing interest rates considerably – even at the price of significantly higher inflation rates.

In contrast, inflation rates in countries with independent central banks focused on delivering price stability were comparatively low in these years. While average inflation in Germany stood at 3.4%, it reached 8.2% in France, 12.5 % in Italy and 12.4% in Spain. The important point here is that lower inflation did not come at the expense of lower growth. It turned out that quite the opposite is true – the best contribution to sustainable growth a central bank can make is to keep prices stable.

But stable prices are not the only prerequisite for growth. A stable financial system is also crucial – this is the lesson of the financial crisis. It is of utmost importance to restore and preserve confidence in the resilience of the financial system as a whole. In this process, central banks play an important role, especially when it comes to mitigating systemic risks, nowadays known as macro-prudential regulation and supervision.

In keeping prices stable and contributing to a stable financial system, central banks can put in place the conditions for sustainable growth. But they cannot deliver this growth on their own. All measures the Eurosystem has taken to contain the fallout of the crisis, like the ECB Governing Council reduced interest rates to a mere 50 basis points, decided to provide banks with quasi unlimited liquidity, and to intervene in bond markets only helped to stabilise output in the short term. The fundamental problems of the euro area are structural in nature. As such, they require a structural solution.

Precarious public finances and a lack of competitiveness are at the root of the current crisis. In some parts of the euro area, these problems are compounded by a very restrictive credit supply of banks. These challenges cannot be overcome by monetary policy. All that central banks can do is to buy time – time for governments and parliaments to consolidate budgets, improve the functioning of product and labour markets and recapitalize banks.

In safeguarding monetary and financial stability, central banks can pave the way for growth. But to actually get there, governments and parliaments must go down the route of implementing the required reforms.